Nos. 04-1704 and 04-1724

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IN THE

Supreme Court of the United States

DAIMLERCHRYSLER CORPORATION,
Petitioner,

v.

CHARLOTTE CUNO, *et al.*,
Respondents.

WILLIAM W. WILKINS, *et. al.*,
Petitioners,

v.

CHARLOTTE CUNO, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

BRIEF OF *AMICI CURIAE* COUNCIL ON STATE TAXATION AND NATIONAL ASSOCIATION OF MANUFACTURERS IN SUPPORT OF PETITIONERS

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BRIEF OF *AMICI CURIAE* COUNCIL ON STATE TAXATION AND NATIONAL ASSOCIATION OF MANUFACTURERS IN SUPPORT OF PETITIONERS

INTRODUCTORY STATEMENT

This brief is submitted by the Counsel On State Taxation and the National Association of Manufacturers as *amici curiae* in support of the Petitioners in the above captioned matter.[1]

[1] No Counsel for a party authored this brief in whole or in part, and no person or entity other than amicus curiae, its members or counsel has made a monetary contribution to the preparation or submission of this

STATEMENT OF INTEREST OF *AMICI CURIAE*

COST is a non-profit trade association formed in 1969 to preserve and promote equitable and nondiscriminatory state and local taxation of multi-jurisdictional business entities. COST represents nearly 600 of the largest corporations in the United States, including companies from every industry segment. Many of the 45 states that impose a form of corporate income tax also incorporate some form of investment tax credit—the concept at issue in this case—or similar incentive and many COST members have utilized investment tax credits from one time to another. Thus, COST members have a financial interest in whether the investment tax credits are valid.

The National Association of Manufacturers ("NAM") is the nation's largest industrial trade association, representing small and large manufacturers in every industrial sector and in all 50 states. The NAM's mission is to enhance the competitiveness of manufacturers by shaping a legislative and regulatory environment conducive to U.S. economic growth and to increase understanding among policymakers, the media and the general public about the vital role of manufacturing to America's economic future and living standards. The members of NAM thus also have a financial interest in whether the investment tax credits are valid.

ARGUMENT

The constitutional analysis adopted by the Sixth Circuit in invalidating the investment tax credit offered by the state of Ohio to DaimlerChrysler is flawed because it needlessly broadens the scope of the dormant Commerce Clause's limitations on states' authority to implement discrete tax systems based on each state's unique economy and populace.

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brief. Petitioners and Respondents have consented to the filing of this brief and their letters have been filed with the Clerk of this Court.

As a result of this flawed interpretation of the dormant Commerce Clause, the Sixth Circuit's analysis and holding create an impossible standard for determining whether a tax system imposes an unconstitutional burden on interstate commerce by impermissibly discriminating against interstate commerce. The Sixth Circuit's standard is impossible to actually implement because under the central premise of the Sixth Circuit's reasoning all state taxes that vary from state to state discriminate against interstate commerce. Such a result is clearly not the intent of the Constitution of the United States and its federalism underpinnings.

The Sixth Circuit commits two interrelated errors in finding the investment tax credit at issue discriminates against interstate commerce. First, the court should have chosen a narrower rule defining when a tax system is discriminatory that reconciled and acknowledged existing precedent of this Court while at the same time limiting the scope of state tax systems that would fail the rule. Second, by drastically expanding the scope of the dormant Commerce Clause's limitations on the states, the Sixth Circuit robs the states of a unique and highly cherished element of the governing theory of the United States—the co-equal status of the states and the federal government. The Sixth Circuit's decision effectively destroys *any* autonomy of the states to choose individualized systems of taxation. While the dormant Commerce Clause exists and is necessary to control the worst aspects of state imposed domestic protectionism through the tax code, the states' loss of all control over all aspects of state fiscal fundraising, as would ultimately be the result of the Sixth Circuit's underlying rationale, is fundamentally contrary to our system of government and leaves the states as merely emasculated administrative arms of the federal government and the courts.

I. THE SIXTH CIRCUIT COURT OF APPEALS CHOSE THE WRONG STANDARD FOR DETERMINING WHETHER A TAX SYSTEM DISCRIMINATES AGAINST INTERSTATE COMMERCE.

The Sixth Circuit applied an unnecessarily overbroad interpretation of the standard under the discrimination prong of the dormant Commerce Clause in finding that the Ohio investment tax credit was unconstitutional. The Sixth Circuit chose to use as the standard the question of whether a tax system prevents "tax-neutral decision making." *Boston Stock Exchange et. al. v. State Tax Commission*, 429 U.S. 318 at 330 (1977). While this language does appear in this Court's historical decisions involving incentives and discrimination against interstate commerce, the language is not reconcilable with business operations and the economy and is not at the heart of any of this Court's decisions in the area.

First, nearly every business decision is premised on tax considerations and it would be irresponsible for taxpayers to ignore tax provisions in evaluating alternatives. Common economic theory posits that all taxes distort activity and the goal of an efficient tax system is to limit such distortions. A classic example is an individual's choice whether to rent a house or to buy a house. All other things being equal (payments, type of house), an individual will choose to buy a house rather than rent because the interest payments on the mortgage are deductible while no part of rental payments are—thus lowering the net cost of buying relative to renting. This is distortive because if the tax results were the same for buying and renting, the individual might have chosen not to use the available credit to buy a house, but instead would have chosen to rent and use the credit to start a dry cleaning business. In a tax neutral world, the dry cleaning business would be a better investment, but once taxes enter the picture the best use of resources is no longer the chosen route because of the tax consequences. There are thousands of

similar examples as to how taxes by nature distort economic choices—retiring to Florida (no income tax), financing a new business with debt instead of equity (interest is deductible, dividends are not), etc. Thus, if the constitutionality of state tax systems were to start with this issue of whether such a system forecloses tax neutral decision making, no tax would pass this threshold hurdle.

Second, not only did the Sixth Circuit latch on to an overly broad standard, but it did so unnecessarily. It is a common rule of statutory construction that courts should choose the narrower rule that upholds the validity of a statute. *NLRB v. Catholic Bishop of Chicago*, 440 U.S. 490 (1979) ("[A]n Act of Congress ought not be construed to violate the Constitution if any other possible construction remains available"). Because a narrower rule is available in this case, the Sixth Circuit failed to adopt the appropriate rule and, thus, this Court should reverse the decision of the Sixth Circuit Court of Appeals and find that the investment tax credit at issue is constitutional.

The Sixth Circuit in this case adopted a very broad standard for applying the discrimination prong of the dormant Commerce Clause. The rule imposed by the Sixth Circuit is that any incentive that affects a taxpayer's decision is per se invalid. This rule is both over-broad (it would sweep in legislative choices such as the corporate tax rate and the type of corporate income tax apportionment formula used to determine state taxable income) and unnecessary in light of existing precedent. The rule that should be applied in determining the constitutionality of a state or local tax incentive under the discrimination prong of the Commerce Clause in the United States Constitution is: *Does the incentive for in-state activity penalize activities occurring in another state?* It is only if the answer to this question is "yes" that the incentive violates the discrimination prong of the U.S. Constitution (hereafter "the Narrow Rule"). This is the rule that

emerges from a careful reading of existing U.S. Supreme Court precedent, and which narrowly proscribes the legislative enactments that could violate such a rule. In the following discussion, each of the cases relied on by the Sixth Circuit in reaching its decision in this case is analyzed in the context of this Narrow Rule to verify consistency. Following that analysis, the investment tax credit that the court ruled unconstitutional is also subjected to this suggested rule. Under the Narrow Rule, the Ohio incentive is in fact constitutional.

The Narrow Rule is applied using four successive steps: first the activity being taxed is defined; second, the taxed activity is assumed to stay at the same level in the taxing state; third, activity in another state is increased; finally, if this increase in activity in another state results in an increase in tax in the taxing state, the tax is unconstitutional. The cases relied on by the Sixth Circuit and the primary United States Supreme Court cases involving Commerce Clause challenges to state tax incentives[1] as discriminating against interstate commerce are: *Westinghouse Electric v. Tully*, 466 U.S. 388 (1983), *West Lynn Creamery v. Healy*, 512 U.S. 186 (1994), *Bacchus Imports v. Director of Taxation*, 468 U.S. 263 (1984), *Maryland v. Louisiana*, 451 U.S. 725 (1981), and *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318 (1977). In each of these cases this Court found the incentive was unconstitutional because it discriminated against interstate commerce. Applying the Narrow Rule as described above results in the same holding in each of these cases but a different result for the case at issue.

In *Westinghouse Electric*[2] the issue was whether a credit against the New York franchise tax for exports from New

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[2] *Westinghouse Electric* is the case most similar to the case at hand because it also involved a credit to a corporate franchise tax based on in-state activity.

York was unconstitutional. The credit was determined first based on the ratio of New York exports to nationwide exports and second by the ratio of New York property, payroll and sales to nationwide property, payroll, and sales. Applying the Narrow Rule—first, the activity taxed in this case was business activity including export sales. Second, the overall business activity, including export sales, in New York is assumed to stay exactly the same. Third, the taxpayer increases its nationwide business activity by adding more export sales in another state. The result is that by increasing non-New York exports but holding New York business activity including export sales exactly the same, the New York export credit is reduced and the New York franchise tax is increased. This occurs because the New York credit is not based on an absolute number related exclusively to New York export activity, but instead varies based on the percentage of the overall national export and business activity market that New York shares.

In *West Lynn Creamery*, the issue was whether a "premium" charged by Massachusetts for milk sales that was used to subsidize in-state milk producers violated the Commerce Clause. The net result of this premium subsidy system was that out-of-state producers selling into the state paid a tax to which in-state producers were not subject. Applying the Narrow Rule, first, the activity taxed was milk sales. Second, the Rule assumes that a taxpayer's sales of milk in Massachusetts remain the same. Third, the taxpayer moves its in-state production facilities to another state. Fourth, the result is that the taxpayer will continue paying the same milk sale premium but will no longer receive the subsidy—the net effect is an increase in tax. Applying the Narrow Rule shows that this tax/subsidy system is unconstitutional.

In *Bacchus Imports*, the issue involved Hawaii imposing an alcohol wholesale excise tax but exempting from that tax the sales of certain types of wines produced only in Hawaii.

Application of the Narrow Rule finds this incentive to be invalid. First, the activity taxed is the sale of alcohol. Second, the total sales of alcohol in Hawaii are assumed to remain exactly the same. Third, the number of sales of non-Hawaii wines increases. The result is that the alcohol excise tax in Hawaii increases even though the total number of Hawaii alcohol sales stayed exactly the same.

In *Maryland v. Louisiana*, the issue was whether a tax by Louisiana on the use of natural gas in the state was discriminatory. An exemption from the use tax was provided for those users of natural gas in certain manufacturing businesses, including manufacturing fertilizer or producing oil, as long as the exempted activity took place within the state.[3] Applying the Narrow Rule—first, the activity taxed was the use of natural gas in Louisiana. Second, the in-state use—first using natural gas in the state—is assumed to stay exactly the same. Third, a taxpayer switches exempt manufacturing activity from in-state to out-of-state. This increase in out-of-state activity while leaving constant the in-state taxed activity increases the in-state use tax because the taxpayer no longer qualifies for an exemption. Thus, the tax scheme is unconstitutional.

Finally, in *Boston Stock Exchange*, New York State imposed an excise tax on the transfer of securities in the state. However, a credit was given against this tax if the transfer involved an in-state sale of those securities. A taxed transfer included any change in ownership through a sale, registration sale, redemption, etc. Applying the Narrow Rule, the activity taxed is the transfer of securities. Second, the Rule requires that the number of transfers taxable in New York is assumed to stay exactly the same. Third, the taxpayer accomplishes

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[3] The tax in this case was considerably more complicated than this brief description and included a credit allowed against an in-state severance tax and a credit against other fuel related taxes.

more of those transfers through out-of-state sales. Fourth, the Rule looks to see if the out-of-state activity causes an increase in New York tax. Here, it does. As an increasing number of securities transfers involved non-New York sales, the taxpayer would be subject to the same transfer tax but receive fewer credits and thus pay a higher tax. The result is that the transfer tax credit violates the Commerce Clause.

While each of this Court's cases resulted in an unconstitutionally discriminatory tax when applying the Narrow Rule, the tax incentive at issue in this case does not. The issue in this case is an investment tax credit. This investment tax credit is awarded for certain types of investment in Ohio and is applied against the Ohio franchise tax. Applying the Narrow Rule—first, the activity taxed is business activity in Ohio. Second, the Rule assumes that the taxpayer's business activity in Ohio stays exactly the same. Third, an increase in investment in another state is postulated. Fourth, the result is that Ohio's tax will stay exactly the same, notwithstanding the increase in out-of-state activity. This occurs because the calculation of the Ohio investment credit includes no reference to out-of-state activity, which is neither incented nor disincented. Thus, unlike the cases noted above, this credit is constitutional.

II. THE SIXTH CIRCUIT FAILED TO GIVE DUE CONSIDERATION TO THE CO-EQUAL STATUS OF THE STATES AND THE FEDERAL GOVERNMENTS AND THE NECESSITY FOR THE STATES TO CONTROL THEIR OWN FISCAL WELL-BEING.

The Sixth Circuit's adoption of a broad standard for finding state tax systems discriminate against interstate commerce, if allowed to stand, will have the ultimate effect of creating but one, completely uniform tax system throughout the 50 states and all local jurisdictions. While this would

certainly make compliance easier (and in some situations may ultimately be necessary to prevent burdening interstate commerce through compliance complexity), in general it is good for the economy and the citizens of each state to choose independently what type of tax system they will have. Without this choice, states will be left at a disadvantage in attracting the types of jobs and industry necessary for the state and its citizens to thrive.

The United States is a large and diverse country. Each state has unique advantages and disadvantages that contribute to its overall economy and success. The differences among the states include geographic, population, and historical growth patterns, etc. Some states, like Florida and California, are blessed with nice weather and lovely beaches. Other states, like Ohio, get sleet. Some states, like Texas and Alaska, have valuable natural resources (oil) that they can exploit financially. Other states, like Ohio, do not. It is this variety in economies, natural resources, and population that create unique burdens and opportunities for each state financially. Part of this financial burden *or* opportunity lies within the choices a state's elected officials make with regard to the tax code.

Perhaps all people and businesses would move to Florida if they could. However, that would be bad for Ohio and bad for our country as a whole as it would put pressure on Florida's existing infrastructure while wasting the land and existing infrastructure of Ohio. Thus, Ohio, among other things, can choose to use its tax code to compete with Florida's beaches. Florida may have sand—but Ohio has valuable investment tax credits.

Similarly, each state may have different needs as far as the type of jobs its citizens are qualified for. Some states, due to historical patterns, may have an unskilled workforce. Such a state may want to attract either businesses that will employ unskilled laborers or provide on-the job training to increase

the skill level. Other states may have an extremely technically advanced population and would find little use in low-skilled jobs. By allowing each state to tailor its tax system to meet the needs of its populace, our federalist system allocates precious resources across the states based on the uniqueness of that state. The perfect tax system for Florida may not be the perfect (or even possible) tax system for Ohio. The Sixth Circuit's decision however, essentially finds that such unique tailoring on a state by state basis is discriminatory because it could foreclose tax neutral decisions.

Taking the Sixth Circuit's reasoning at face value, many common tax systems, not just the incentives at issue here, would clearly be unconstitutional. For example, several states over the years have chosen to move from apportioning the income of a multistate corporate taxpayer based on the percentage of that taxpayer's property, payroll and sales in the taxing state to only using a single factor—sales—to determine the percentage of income taxable in this state. Many businesses, when considering a new facility location, may find such an apportionment formula attractive because it does not increase the business's tax when it adds a facility and payroll in the state. However, such "tax influenced" decision-making would doom alternatives to the three factor system and ultimately require that all states adopt identical apportionment formulas. The same thing can be said for differences in tax rates (some businesses may choose to locate in states with lower statutory rates) and differences in taxes themselves (some businesses may be attracted to Nevada because it does not impose a corporate income tax). Tax rates, tax types, apportionment formulas, and even what goes into the tax base vary drastically among the states. Under the Sixth Circuit's reasoning, if taxpayers' were to take into account these variations, then all variations would be unconstitutional.

Hence, in order to preserve any type of federalism and state autonomy over the fisc, the Sixth Circuit's sweeping en-

dorsement of the "tax-neutral decision making" theory must be abandoned. Once its limitless scope and the ultimate result of a homogenized state tax system is understood, the Sixth Circuit's rationale falls of its own weight.

CONCLUSION

Because the Sixth Circuit could have chosen a narrower rule in determining whether the Ohio investment tax credit unconstitutionally discriminated against interstate commerce and such a rule would both be consistent with this Court's precedent and would uphold the incentive at issue in this case and similar incentives in the other 45 states imposing a corporate income tax, COST and NAM ask this court to reverse the decision of the Sixth Circuit and hold the Ohio investment tax credits are constitutional.

Respectfully submitted,

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